1812

THE NATIONAL CITY BANK OF NEW YORK EST. 1812

1945

Economic Conditions
Governmental Finance
United States Securities

New York, February, 1945

General Business Conditions

THE sensational drive of the Russian armies into Germany, together with the Allied successes in the West and the swift overrunning of Luzon, has made January one of the most eventful months of the war. If nothing more had been gained than the Russian sweep into the Upper Silesian industrial basin this alone would represent a great victory, for in this basin, including German, Polish and Czech districts, the Germans have built a concentration of industries second only to those of the Ruhr and Rhineland. Now they have lost most of these industries. During the remainder of the war they will have to depend for their coal, their primary steel products and other heavy goods largely upon a territory subject to continuous bombing and likely soon to be within range of Allied guns.

The importance of the Upper Silesian basin, like that of the Ruhr Valley, is founded upon its rich bituminous coal mines. It has also zinc, lead and small iron ore deposits. Since the outbreak of the war its heavy industries and its munitions output have been greatly expanded through coordination with Czech and Polish plants, transfers from bombed districts, and introduction of new industries, principally chemical, based on hydrogenation of coal. Bituminous coal production, 75 million tons annually before the war, is believed to have been expanded to nearly 100 million tons, and the munitions industries of Czechoslovakia and Austria depend chiefly on this coal. Steel-making capacity, 4 million tons annually before the war, was scheduled for expansion to 6 million tons. In zinc the district produced about two-thirds and in lead about one-half of the supply under German control a month ago.

On the basis of prewar production figures, the Germans on June 6 last controlled about 340 million tons of bituminous coal output annually and have now lost more than 180 million of this total. The bulk of the remainder, 130 million tons in the Ruhr and 13 million in the Saar, is in danger. Of 480,000 tons of zinc production and 240,000 of lead production controlled on D-Day, only about 90,000 and 60,000, respectively, remain in German hands. The 57 million tons of steel ingot producing capacity is now reduced to the 16 million of the Ruhr and 10 million of the Saar, Czechoslovakia, Austria, and other areas.

How much new capacity has been built and how much has been put out of operation by bomb damage is not known. The figures show, nevertheless, that the loss of the Upper Silesian district will inevitably speed the deterioration of the German war machine. Further loss of the mines and heavy industries of the Ruhr and the Saar would be fatal, for remaining industrial districts could not long operate efficiently without them. German food supplies also will be affected by her territorial losses. German territory east of the Stettin-Frankfurt line, including East Prussia, normally produces almost 30 per cent of the supply of such staples as rye, sugar beets and potatoes, on which the industrial population further west depends.

The Domestic Situation

In this country the war effort is expanding to meet the enlarged munitions program for 1945, recently calculated by Mr. Krug, chairman of the War Production Board, at $64.5 billion compared with $56.5 billion scheduled last October; and the drive to keep the effort at maximum has been intensified. New moves by the Washington agencies to deal with manpower, production and price problems, and to restrict use of materials and civilian activity, have been following one another almost as closely as in the days of 1942, when the war economy was taking shape. Were it not for the lesson taught by the German drive into Belgium in December, it is likely that general opinion would now be anticipating an early end of the European war and sharp cutbacks in war requirements. But that experience taught the mistake of counting upon an end at any definite time, and the danger of preparing

for anything but the worst. The country is committed to a maximum effort until the military authorities themselves decide that some relaxation is feasible.

The enlarged military programs and the pressure to turn out critical items rapidly have been felt throughout industry. Incoming orders have risen, backlogs have increased, and supplies of raw materials have tightened. Labor shortages are critical in the areas receiving the new war orders. Growing scarcities of civilian goods keep retail buyers in the markets for all they can get. On the basis of military requirements as they now stand civilian supplies during the first half of 1945 will be shorter than at any previous time. The "spot authorization" plan for permitting resumption of civilian production where the war effort would not be impeded has almost dried up, through further restrictions on new authorizations and lack of materials or parts for goods already authorized. The authority given machinery manufacturers to take nonwar orders for postwar delivery, granted last July, has been revoked as unfilled orders for machinery for war plants have piled up.

In raw materials the metals particularly have felt the effects of the quickened war program. Iron Age reports that steel users who a few months ago were inventory-conscious are now crowding for deliveries and placing orders further ahead. Stockpiles of nonferrous metals, which for some time had been rising steadily, have turned downward; new restrictions have been placed on civilian use and steps taken to increase both domestic production and imports. Brass mills have sharply stepped up purchases of copper and zinc and deliveries of both metals are heading for new wartime peaks. Lead is back on the critical list. Requirements for sheet aluminum have been stepped up and are expected during the first half of 1945 to dig deeply into the large stockpile of primary aluminum.

In the textiles increased diversion of cotton, woolen and rayon yarns into the war effort has progressively tightened the clothing situation to a point where the War Production Board and the Office of Price Administration have announced a sweeping program of allocation of yarns and fabrics and new price control measures, to increase supplies of medium and low priced essential goods at the expense of non-essential and higher priced lines. In foods the inability to release military reserves is a factor in the resumption of rationing on a considerable list of products.

Limits on Overall Production

This brief summary describes a situation tighter in nearly all respects than it was six months ago, and considerably tighter than most people had expected it to be at this time. The chief difficulties in the way of expanding production are shortages of manpower in certain places and the impossibility, when all facilities are under strain, of always having the right people and the right things at the right place at the right time. The sideways course of the indexes of industrial production implies that the industries are working at their practicable ceiling. Undoubtedly there is still room to tighten up the productive organization and increase the output per worker. But when difficulties are overcome in one place they are likely to appear in others, and such unpredictable interferences as the transportation congestion caused during the month by cold and snow in the Northeastern States have to be reckoned with. The fuel supply is of concern in many places.

The business situation will change of course when the military situation permits the war production program to be cut back, and both manufacturers and distributors have this in mind in setting their policies. The military situation, after the anxious days of December, is again one of high promise; and the sense that "anything may happen" in the weeks or even days ahead is acute. Until it does happen, however, the need is to apply still more energy and devotion to the war effort in every possible way—above all to speed the production of critical items.

Finally, everyone should recognize that with civilian supplies shortening and incomes undiminished the price and wage stabilization program faces its supreme test. The need for intensified efforts to hold the line is apparent. It should be a strong consideration in planning postwar government fiscal programs; for if these programs are extravagant and inflationary, they will tend to induce private extravagance now, instead of the restraint and saving that are vital if this battle is to be won.

The President's Budget Message

The President's budget message, presented to the Congress last month, is less a war budget message than it is a peace budget message. Recognizing the tentative character of expenditure estimates based on the duration of the war, the President devoted most of his discussion to postwar expenditures and to the role of fiscal policy in the long-range problem of maintaining employment.

In estimating war expenditures, the President follows the only sound budgetary course of assuming continuing global war through the fiscal year ending June 30, 1946. Even so, he says, the uncertainties are such that estimates for that year may reasonably range from less than $60 billion to more than $80 billion. The President splits the difference and calls it $70 billion, which compares with his revised esti-

mates of $88 billion for the current fiscal year ending next June, a reduction of $18 billion.

If these estimates are realized it will mean the first reduction in war expenditures since the outbreak of the war. That such a reduction is considered possible notwithstanding the assumption of continuing war in Europe and Asia reflects the culmination of the build-up phase of the war program and its shift to more largely a maintenance basis.

Notwithstanding an estimated rise in nonwar costs, to which we shall revert later, total expenditures are budgeted at $82½ billion for fiscal 1946, against an estimated $99 billion for the current fiscal year, and $94 billion actually reported for fiscal 1944. These totals are exclusive of government agency net expenditures, which are now declining and are estimated for next year at less than $1 billion.

The President proposes no substantial changes in taxation, but estimates that the decline in expenditures will result in a decline in receipts from $45.7 billion in fiscal 1945 to $41.2 billion in fiscal 1946. On this basis the federal deficit next year will total $41.3 billion, against $53.2 billion this year, carrying the federal debt by June 30, 1946 to $292 billion—an average of approximately $2,100 for every man, woman, and child.

United States Government Receipts and Expenditures 1914-1946
(In Millions of Dollars)

Year Ended June 30	Total Net Receipts	Net Expenditures: National Defense	Net Expenditures: All Other	Net Expenditures: Net Total	Net Surplus or Deficit
1914	$ 735	$ 263	$ 472	$ 735	$ ...
1915	698	268	493	761	—63
1916	783	286	448	734	+48
1917	1,124	1,452	526	1,978	— 853
1918	3,665	10,838	1,859	12,697	— 9,033
1919	5,152	14,444	4,071	18,515	—13,363
1920	6,995	2,718	3,685	6,403	+ 292
1921	5,625	1,767	3,349	5,116	+ 509
1922	4,109	888	2,485	3,373	+ 736
1923	4,007	675	2,620	3,295	+ 712
1924	4,012	603	2,446	3,049	+ 963
1925	3,780	626	2,437	3,063	+ 717
1926	3,963	599	2,499	3,098	+ 865
1927	4,129	614	2,360	2,974	+ 1,155
1928	4,042	643	2,460	3,103	+ 939
1929	4,033	698	2,601	3,299	+ 734
1930	4,178	721	2,719	3,440	+ 738
1931	3,190	667	3,004	3,671	— 481
1932	2,006	664	3,871	4,535	— 2,529
1933	2,080	651	3,213	3,864	— 1,784
1934	3,116	578	5,433	6,011	— 2,895
1935	3,800	726	6,284	7,010	— 3,210
1936	4,116	940	7,726	8,666	— 4,550
1937	5,029	967	7,210	8,177	— 3,148
1938	5,855	1,066	6,173	7,239	— 1,384
1939	5,165	1,251	7,456	8,707	— 3,542
1940	5,387	1,711	7,287	8,998	— 3,611
1941	7,607	6,301	6,409	12,710	— 5,103
1942	12,799	26,011	6,385	32,396	—19,597
1943	22,282	72,109	6,070	78,179	—55,897
1944	44,149	87,039	6,705	93,744	—49,595
1945‡	45,730	88,000	10,912	98,912	—53,183
1946†	41,255	69,400	13,130	82,530	—41,276

United States Government Public Debt. 1914-1945
(In Millions of Dollars)

June 30	Total	June 30	Total	June 30	Total
1914	$ 1,188	1925	20,516	1936	33,778
1915	1,191	1926	19,643	1937	36,425
1916	1,225	1927	18,510	1938	37,165
1917	2,976	1928	17,604	1939	40,440
1918	12,244	1929	16,931	1940	42,968
1919	25,482	1930	16,185	1941	48,961
1920	24,298	1931	16,801	1942	72,422
1921	23,976	1932	19,487	1943	136,696
1922	22,964	1933	22,539	1944	201,003
1923	22,350	1934	27,053	1945‡	251,800
1924	21,251	1935	28,701	1946†	292,300

Source: Compiled from President's Budget Messages and Annual Reports of the Secretary of the Treasury Expenditures exclude net appropriations to old-age insurance trust funds, while corresponding social security taxes are excluded from net receipts. Expenditures exclude sinking fund for debt retirement. National defense total excludes expenditures charged to War Department for rivers and harbors, and flood control; also for Panama Canal; but include loans to foreign governments in 1917-21 and lease-lend in 1941-46. †Budget estimate. ‡Revised budget estimate. Above figures do not include government agency net expenditures or guaranteed debt.

Growth of Nonwar Costs

Perhaps the most significant feature of the budget figures, from the long-range viewpoint. is the rapid growth of nonwar costs. The total of such expenditures for 1946 is estimated at more than $13 billion which, as shown by the long-term summary is approximately twice as high as before this war, and five times as high as the average of the 1920s.

The principal items in this increase are expenditures for interest on the public debt, veterans' pensions and benefits, and tax refunds. As the President pointed out in his budget message, the total expenditures for these purposes have increased from $1.6 billion in 1939 to an estimated $7.2 billion in the current fiscal year, and will probably amount to $9.8 billion next year, or approximately 75 per cent of the nonwar budget.

Condensed Summary of Government Nonwar Expenditures in Fiscal Years 1939 and 1946
(In Millions of Dollars)

	1939 Actual	1946 Budget
Interest on the public debt	$ 941	$ 4,500
Tax refunds	68	2,725
Veterans' pensions and benefits	550	2,612
Aids to Agriculture	1,043	410
Social security, relief and retirement		
Social security program*	347	498
Work relief	2,612	14
Retirement funds (gov't employes)	182	489
Aids to youth	368	......
General public works program	505	394
General government	949	1,143
Supplemental items & adjustments	—111	347
Total nonwar expenditures	$7,456	$13,130

*Administrative expenses and grants only; excludes net appropriations of social security taxes to old-age insurance trust funds.

Nor does the $13 billion estimate for 1946 give by any means a full measure of the level to which these costs are heading. Veterans'

pensions and benefits, including separation pay and the so-called "G.I." loans already provided for in existing legislation, but not including such additional benefits or bonuses as may be voted in subsequent legislation, are not expected to reach their peak for some years to come. Similarly, the peak of tax refunds is expected to come later.

Interest on the public debt — estimated at $4.5 billion for 1946, or half again as large as the total cost of government in the 1920s — would increase further with an expansion of total debt, even assuming no rise in interest rates.

Many of the other nonwar costs, estimated at $2.3 billion for 1946, are certain to be much higher. Aids to agriculture and the general public works program, set down at $400 million each, are the lowest in years and far out of line with the ambitious programs for expenditures in both fields outlined in the budget message. The President said:

> The agricultural budget is a wartime budget. It does not fully reflect desirable long-term objectives. In the future we must develop a program to eliminate malnutrition and rural poverty. The Government is committed to support agricultural prices to farmers at a fair level for two years after the war. Farmers and the nation as a whole must be protected from heavy fluctuations in agricultural prices and income, and this must be accomplished without the accumulation of unmanageable surpluses.

The President wants increased borrowing authority for the Farm Security Administration and for the Rural Electrification Administration, and calls attention to an earlier recommendation for a $2 billion increase in the borrowing power of the Commodity Credit Corporation. Recommendations for financing federal crop insurance are to come "in the very near future."

Suggestion of an expanded public works program is provided by items in the budget for the completion of plans for highways, flood control, river development, stream pollution control, power transmission, reclamation, hospital, and other construction, as already authorized by law, and by encouragement given by the President for stocking "a shelf of meritorious construction and development projects to be undertaken as manpower and material become available." In addition, plans are under way for federal loans and guarantees to stimulate private building.

The message calls for a program to include "provision for extended social security, including medical care; for better education, public health, and nutrition; for the improvement of our homes, cities, and farms; and for the development of transportation facilities and river valleys." The President asks for government assistance for travel and retraining of war workers during reconversion, notwithstanding the high wages being paid in the war industries. He wants unemployment benefits liberalized, and salaries of federal employes increased.

In the foreign field, the President speaks of the postwar needs for relief and rehabilitation and for encouragement of foreign trade. He proposes additional lending power for the Export-Import Bank, and urges American acceptance of the Bretton Woods plans for an International Monetary Fund and an International Bank for Reconstruction and Development which, if adopted in full, would mean a commitment for this country of approximately $6 billion.

What does all this proposed spending and lending mount up to? If we take the projected $13 billion of nonwar expenditures for 1946 as a starter, and add a possible $5 billion of postwar costs for a permanently enlarged Army and Air Force and two-ocean Navy, the result is a total of $18 billion, without allowing for any of the increases specifically forecast in the budget message.

What we seem to be pointing towards is a level of postwar federal expenditures that may easily reach $25 billion, as the President suggests when he asks, "What will be the outlook when federal expenditures are $50 billion and $25 billion in the period of demobilization and thereafter?" Even the figure of $25 billion may prove to be too low if government spending and subsidies are looked to as a major reliance for reaching desired social objectives.

Debt and Tax Policy

The questions may be raised how are we going to get the tax relief that is needed to stimulate postwar enterprise; how are we ever going to get the budget under control? Though the President takes cognizance of problems of manpower and materials in outlining projects for government spending, he omits reference to where the money is coming from.

"The management of the public debt," the President declares, "is bound to have a profound influence on the economy for a long time to come." His discussion of the debt problem, however, has caused much puzzlement and apparently involves some contradictions. While he declares in favor of a policy of "orderly but steady debt reduction," he qualifies this by adding "consistent with the objectives of long-run economic policy," and his advocacy of debt reduction seems contrary to the whole spirit of the budget message which is one of lavish spending.

The President asserts that "retaining high taxes on the masses of consumers for general reduction of debt held by financial institutions may destroy purchasing power and create un-

employment," but at the same time states that "the use of progressive taxes for the redemption of bonds held by millions of individual savers may have a stabilizing influence on incomes and employment." While the meaning of this passage is not entirely clear, it suggests the familiar "oversavings" theory that promotion of business activity requires heavy taxes on the larger incomes where "oversaving" would otherwise occur, and reduced taxes on the lower incomes which would otherwise be spent. Yet in still another part of the message the President names the promotion of business investment as one of the objectives of postwar tax policy. How can this occur if savings available for such investment are taxed away?

The President's statement that "the mistakes in debt management and tax policy after the last war should not be repeated" has likewise caused perplexity, since he does not explain whether he thinks the debt was retired too fast or not fast enough. From the wartime peak in 1919 to the end of 1930, total annual expenditures were reduced from approximately \$18.5 billion to \$3.4 billion, public debt was reduced from \$26.5 billion to \$16 billion, and there were four major reductions of tax rates. This record of debt management and tax policy has heretofore been looked upon as highly creditable, and was accompanied by a period of great prosperity and of expanding business and employment.

Deficit Spending for Full Employment

Even more important than the individual proposals for Treasury expenditures and use of government credit is the acceptance in the budget message of the philosophy of government spending for maintaining full employment.

The President refers to the objective of 60 million jobs, and asks, what is going to happen when the war is over? Continuing, he says:

> Full employment in peacetime can be assured only when the reduction in war demand is approximately offset by additional peacetime demand from millions of consumers, businesses, and farmers, and by federal, state, and local governments. And that means consumers' expenditures and business investments must increase by about 50 per cent, measured in constant prices, above the level of the year 1939 if full employment is to be provided by private enterprise.

The implication is that unless private enterprise can provide a postwar level of employment and national income nearly equal to that during the war, government must step in and do the job through spending. The fact is—quite apart from the question, discussed in our December Bank Letter, of whether there are 60 million persons in this country who really want continuous jobs—that it is not desirable for the economic system to be driven at 100 per cent of capacity, regardless of whether the steam be supplied by a private enterprise boom or by a deficit financing boom. In either case the effect is to create bottlenecks and inflationary pressures of all kinds that drive up prices and costs. During the war the effects of such pressures are retarded by price controls and other restrictions which most Americans hope to get rid of as soon as possible when the war is over.

All this does indeed raise the fundamental question as to whether deficit financing can bring about the sound and enduring expansion of production and employment universally desired. There is nothing in the record of the deficit financing during the 1930s to substantiate the theory that it can. Although the President's budget messages during that period repeatedly promised an early balancing of the budget, the actual achievement of this goal was constantly postponed.

Finally, there is the question of whether in our thinking about the problems of postwar readjustment, we are not being unduly influenced by the memory of conditions in the 1930s, when we were constantly contending with unemployment and striving to build up purchasing power. Today we may be underestimating the force of inflationary elements now accumulating. Potentialities for a great wave of spending lie in the huge expansion of bank deposits and currency since 1939, and in the pent-up demand for goods of almost every description for consumers and for the industries. We refer in a following article to postwar public works projects of federal, state and local governments running into billions of dollars.

We need perhaps to recall the experience in the years following the last war, but before the depression period, when the cessation of government spending and budget deficits did not bring deflation but instead there was serious inflation. As shown by the long-term table above, in 1919-20 the government finances shifted from a relatively heavy deficit to a surplus in one year, yet business activity expanded into a boom that was followed by the collapse of 1921.

There is a human tendency, in economic as in military planning, to fight the "last battle" over again. Actually, the pattern of the past is seldom repeated and it is the new dangers that need to be foreseen and guarded against. In our natural desire to forearm against deflation, we may over-shoot the mark and precipitate inflation instead.

Improvement in State Finances

State government finances for another year have benefited strongly from the wartime expansion in incomes and economic activity. Yields from corporation, income, sales and luxury taxes once again have more than offset the shrinkage of highway, cigarette and other taxes affected by rationing and scarcity.

This abundance of income, coinciding with minimum relief demands and postponed construction expenditures, has created a situation which, while unusually favorable at the moment, will require good fiscal management to preserve the fullest benefits for the postwar era. So far the challenge has been met by most states, for rarely has there been such diligence in building up and harboring surplus funds. Some states have labeled the accumulation simply a postwar reserve fund, others have combined it with a veterans' benefit program, and still others have earmarked a portion as a direct offset of debt now outstanding. While the accumulations are beginning to create a restiveness here and there to reduce taxation and divert some of the surplus, by and large the states are successfully holding to their desire to be prepared for the problems to come.

A state-by-state tabulation of accumulated funds would be interesting, but with different accounting practices and lack of uniformity in fiscal year dates, calculations are difficult. The total amount, however, has been estimated at over $2 billion, and budget estimates indicate that it is bound to increase. New York, for example, anticipates a Treasury surplus on April 1 of $150 million, which is being added to the $163 million locked up last year for postwar purposes. Pennsylvania estimates a biennial surplus on May 1 of $170 million, or $70 million above the total accumulated through last year. North Carolina reports a surplus of $57.6 million as against $39.3 a year ago; South Carolina, $8.3 million against $3.6; Maine, $8.9 million as against $4.8. New Jersey has designed its 1945-46 budget to produce a $68.5 million postwar fund by June 1, 1946. Many states have yet to report, but from these few the trend seems apparent.

In a growing list of states a portion of surplus is being utilized to offset or reduce outstanding tax-supported indebtedness. Reserves have been established by Iowa, South Dakota, Utah, Virginia, Washington and South Carolina to offset debt of the general fund category. North Carolina within recent weeks has transferred a surplus of some $51 million to the sinking fund to be devoted to principal and interest payments; as in other instances of non-callable obligations, the money will be invested in state and U. S. Treasury bonds in an amount sufficient to meet all payments on general fund indebtedness. Connecticut had accumulated in 1944 sufficient reserves to offset all debt payable from general revenues, leaving unreserved approximately $10 million serviced from special revenues. Mississippi likewise has established a fund to pay off all general obligation debt at maturity, leaving about $50 million of outstanding highway debt which is to be paid from highway revenues. Other states have made partial offsets.

From the above examples, it appears that the desire to liquidate debt is nation-wide. By the end of the current year the states as a whole will have accumulated surpluses almost equal to the $2,768,000,000 total of their indebtedness in 1944.

Postwar Plans

Scarcely a day passes without new announcements of postwar plans by the Federal Government, states and municipalities. Some of these are well advanced and ready to be started at the earliest opportunity. Some are still being blueprinted, while others are just in the idea stage. At the request of the House Committee on Post-War Economic Planning and Policy, the Federal Works Agency in collaboration with the Bureau of the Census completed a survey that indicated a total of almost $13 billion for all plans, excluding highway projects. The reported estimate was based on the following division of postwar public works projects:

Summary of Estimated Cost of Proposed Postwar Projects For All Governmental Units Reporting

Stage of Plan Preparation	Number of Governmental Units Reporting	Number of Projects	Estimated Cost of Projects, Including Land ($000s)
I—Completed	600	6,559	$ 969,858
II—Design	655	7,920	1,749,242
III—Preliminary....	740	14,791	3,701,884
IV—Idea	956	27,513	6,297,387

In a survey of state plans, the Council of State Governments has reported that public works projects in the "ready-to-go" stage total $823 million for the 24 states covered, with an additional $3,917 million in the idea stage. These figures exclude highway plans and comprise for the most part construction of public buildings, hospitals, schools, grade crossings, irrigation, etc.

Vast highway construction programs are also being planned. New York's Governor Dewey in his recent budget message mentioned that more than $800 million would be needed to cover plans that are being worked out with municipalities to provide necessary highways, parkways, throughways and grade crossings. Others listed by the Council of State Governments include Massachusetts, $100 million; California, $80 million; Oklahoma, $75 million; Connecticut, $32 million either in the initial or ready-to-go stages. Michigan has in mind plans involving $135 million, while Florida is contemplating a ten-year program to total $160 million.

The projects of the largest cities are even more ambitious. New York City has over $1.2 billion in various degrees of planning, of

which the city hopes that at least half will be covered by federal and state grants and by private capital. Chicago projects total over $900 million, over half of which, according to present estimates, will be financed from special revenues. Detroit's plans total about $270 million. Philadelphia has proposed a program for 1945-50 estimated to cost $205 million. Los Angeles will spread its $400 million program over six years, while Cleveland will defer almost half of its $170 million projects until after 1950. Particularly noteworthy is Milwaukee's statement that its six-year $22 million program will be financed on a cash basis from current taxes. While municipalities generally have had operating surpluses, the war has not been as generous to them as to state governments in the accumulating of cash reserves; in consequence, their postwar improvement programs must be financed mainly through borrowing.

Two Problems

In other words, the conclusion of the war threatens to let loose the greatest concentrated spending in the history of states and municipalities. Among the many problems involved are two of general application: first, the timing of this spending to obtain the maximum national benefits in supplementing rather than competing with private employment, and second, the temptation to continue an unwarranted reliance upon the Federal Treasury for the financing of public works. These problems are interrelated, because in almost all instances, state and local plans hitherto made are based upon generous aid from the Federal Government, so that the extent of the actual fulfillment will be determined by the attitude of Washington. There the spirit of generosity seems to prevail at the moment, for only recently a $1½ billion Post-War Federal-Aid Highway Act was approved, which will distribute $500 million a year for three successive postwar years to states for highway development. Another plan being contemplated would provide $1 billion for airport construction, with the Federal Government matching the funds of states and municipalities.

It is to be hoped that the planners will swing more and more toward projects which can be fully financed by the states and their subdivisions. The federal aid policy ought to be reexamined in light of the war debt now loaded on the Federal Treasury and of the vast improvement in the finances of states and municipalities. It is only logical that they be called upon for full support of essential projects, while the Federal Treasury has the duty of getting its own debt in order.

On this subject, the June, 1944, bulletin of the publication "New Hampshire Taxpayer" has this to say:

The federal debt is now close to two hundred billions. When the war ends, it may well be three hundred billions, or about $9,000 for every American family, someday, to pay back. On the other hand our state and local governments have the lowest debts of fifteen or more years. In spite of this contrast, many pressure groups are already stretching out anxious fingers for "easy" federal money.

Among these proposals are several which would hugely expand the level of federal aid to the states. The federal aid to education bill of 1943 was one of these. Another is a three billion dollar road bill, which would for three years pay New Hampshire $5,000,000. This is an amount equal to what our state paid on all our state roads in an average year before the war. It has been estimated that a quarter million a year, above our normal requirements, would bring our state roads to maximum satisfaction. It has also been estimated that gasoline taxes are almost certain to boom, so that our larger road expenses can easily be covered by larger income. New Hampshire, therefore, does not need this $5,000,000 a year of federal money. It can take care of itself.

These proposals are usually sugar-coated with the appeal that they make jobs for returning soldiers. They also make taxes to be paid by those same soldiers . . . None have the flexibility to permit the spending only if unemployment renders public works essential to create jobs. As a result, if the anticipated postwar boom actually occurs, these proposals would result in competition for labor and materials between the government projects and private employers. The taxpayer would be the sufferer, and no one but the politician handing out the project would be the gainer.

State and Municipal Debt

In a recent bulletin, the Bureau of the Census estimated that the gross indebtedness of states and municipalities on June 30, 1944 amounted to $17,400 million. This was the second consecutive year in which debt had been reduced by about $1 billion. The peak figure was reached on June 30, 1940, when total debt amounted to $20,200 million. At that level it was approximately twice the 1922 figure and ten times the 1902 total. The reduction since 1940 amounts to $2,800 million, or 14 per cent. Of the present amount, states account for $2,768 million, or 15.8 per cent, and municipalities for $14,703 million, or 84.2 per cent. About $1,685 million is classified as "revenue" debt.

The above figures are gross and do not take into account sinking fund assets. These totaled $2,473 million, or a net debt position of $14,927 million for all states and municipalities on June 30, 1944.

If we assume a good volume of business activity after the war, states and municipalities will have some additional borrowing power. Their problem will be to use it wisely: not to waste it; not to accentuate an inflationary surge; not to compete with enterprise for men or materials; but to use it at times and in ways that will aid in business stability and contribute the maximum to the people's well being. This will take great restraint.

The Recovery in Railroad Credit

The past few months have been a history-making period in the railroad bond market. Well-secured obligations of the roads have risen to the highest prices ever reached by comparable issues, and large public offerings to refund outstanding securities, at net interest costs to the carriers which in many cases are the lowest ever recorded, have been outstandingly successful. These developments signify a phenomenal recovery in rail credit as compared with the dark days of only a few years ago. They are of broad economic importance in view of the essential nature of rail transportation and the volume and widespread distribution of rail securities outstanding; and for the same reasons they have profoundly encouraging implications for the future.

The previous historical price peak in high grade rail bonds, according to long-term indexes, was reached in June 1899 when average yields approximated 3 per cent. In the present market Moody's index of Aaa bond yields, which in 1932 had been as high as 6.75 per cent, and one year ago reached 3.01 per cent, has now declined to 2.86 per cent. Expressed on an equivalent price basis for a 4 per cent 25-year bond, this would mean a recovery from around 67 in 1932 to 117¼ a year ago and 120¼ today. Among railroad bonds of lower rating and those in default, the recovery has been even more striking. Moody's Baa rails, which yielded 14 per cent at the 1932 low, sold on a 4.45 per cent basis a year ago and yield 3.8 per cent now, and the Dow-Jones index of defaulted bond prices has risen in the past year alone from 35½ to 46.

Within the past six months over half a billion dollars, or nearly 10 per cent of the publicly held funded debt of the solvent railroads, has been replaced by new bonds averaging over ¾ per cent lower coupon and generally with a more distant maturity. These low yield bonds, maturing mostly in 30 to nearly 60 years, impressively represent the market's recognition of the improvement in railway credit; and subsequent price rises show how well the issues have been received. As will be seen from the accompanying table, the price advances have been spectacular even in the short period of three to five months.

Although the general ease in the money market has contributed to the low cost of railroad borrowing, the chief factor is the marked improvement in railroad credit. This improvement has been accomplished by a combination of increased traffic efficiently handled and sound financial management. Varying with individual circumstances, it assumes one or more of these aspects: (1) reduction of debt, (2) reduction of fixed charges, (3) increase in cash and in net current assets, (4) replacement of fixed interest by interest contingent on income, and (5) extension of maturities.

In 1941 all railroads in the United States, with net investment in road, equipment, materials and supplies of $22.8 billion, had $10.6 billion of bonds outstanding in the hands of the public. During the subsequent three years this figure was reduced to under $9 billion, mainly through purchase or retirement, and the insolvent roads have drawn up reorganization plans under which debt will be reduced by at least another $1.3 billion. Under these plans, also, income bonds are replacing fixed interest bonds to the extent of around $1 billion, so that the original fixed interest debt will be reduced to between $6 and $7 billion.

As a result of these debt reductions and lowering of interest rates by refunding and reorganization, fixed interest charges on

Representative New Railroad and Terminal Bond Offerings in 1944 and January 1945

Company	Issue	Due	Amount Offered	At Offering Price	At Offering Yield to Maturity	Jan. 30, 1945 Price	Jan. 30, 1945 Yield to Maturity
Chicago, Burlington & Quincy RR.	1st & Ref. 3¾s	1974	$40,000,000	100¾	3.72	105⅝	3.46
Chicago Union Station Co.	1st Mtge. 2⅞s	1963	37,800,000	101½	2.77	102⅞	2.68
Chicago Union Station Co.	Serial Notes	1945-54	6,200,000	....	1.82	....	1.82
Cincinnati Union Terminal Co.	1st Mtge. 2¾s	1974	24,000,000	101.85	2.66	102¾	2.62
Cleveland & Pittsburgh RR.	Gen. & Ref. 3s	1974	11,000,000	100.45	2.97	**	**
Erie Railroad Company	1st Cons. 3¼s	1964	13,000,000	100	3.25	102¼	3.05
Great Northern Railway Co.	Gen. 3⅛s	1960	35,000,000	101.52	3.00	103¾	2.82
Great Northern Railway Co.	Gen. 3⅜s	1970	30,000,000	101.28	3.30	106½	3.00
Great Northern Railway Co.	Gen. 3½s	1980	35,000,000	102.04	3.40	106¾	3.18
Gulf, Mobile & Ohio RR.	1st & Ref. 3¾s	1969	10,500,000	98¾	3.83	100⅞	3.70
Kansas City Terminal Co.	1st Mtge. Serial	1948-73	47,000,000	....	1.50-2.76	....	1.50-2.76
Louisville & Nashville R.R.	1st & Ref. 3⅜s	2003	53,835,000	105.88	3.15	105.88	3.15
New York, Chicago & St. Louis RR.	Ref. 3¾s	1975	42,000,000	102	3.64	103¼	3.56
Oregon-Washington RR. & Nav. Co.	Ref. 3s	1960	54,750,000	102⅞	2.78	105¼	2.59
Pennsylvania Railroad	Gen. Mtge. 3⅛s	1985	51,782,000	101.68	3.05	101.68	3.05
Pittsburgh, Cincinnati, Chi. & St. L.	Div. & Gen. 3⅜s	1975	23,735,000	102	3.27	106	3.07
Texas Pacific-Missouri Pac. Term.	RR. Mtge. 3⅜s	1974	6,040,000	101.95	3.27	104	3.01
Washington Terminal Co.	1st Mtge. 2⅝s	1970	11,000,000	106.38	2.55	106.38	2.55

** No quotation — privately bought.

funded debt of all U. S. railroads, upon consummation of present reorganizations, will have been decreased since 1941 from $545 million to around $350 million, and nearly all near term maturities will have been paid off or extended. In the same period excess of current assets over current liabilities including funded debt maturing within six months has increased from $800 million to $1,500 million.

What Individual Roads Have Done

The Great Northern is typical of those which, by careful management, by paying nominal dividends, and by successful refundings, have reduced both funded debt and fixed charges. By operation of sinking funds and by much larger extra purchases of bonds, and by conversion of $23.7 million bonds to stock in 1944-1945, funded debt in the hands of the public has been reduced from $353 million in 1932 to $247 million, after giving effect to conversions, a 30 per cent decrease. Interest charges have been cut by debt reduction and refunding from $18.9 million to $9.4 million, or 50 per cent, in the same period. In addition, property has been improved and cash balances increased.

America's largest carrier, the Pennsylvania Railroad Company, notwithstanding $197 million additions to property investment since 1937, in the last seven years has retired $163 million debt. Analysis of the $88 million debt reduction which was effected during the three years 1942 to 1944 shows that $56 million was accounted for by payments of maturing bonds, $21½ million by purchases in advance of maturity, $9 million by refunding operations (net) and $1½ million by operation of sinking funds. By reason of the 7-year debt reductions and seven refundings since the middle of 1943, including January 1945, interest charges have been reduced approximately $7.3 million, or 16 per cent; further savings in fixed charges have been made by purchase of $31 million guaranteed stocks and by refinancing bonds of a number of jointly owned terminal companies.

The Louisville and Nashville, by accumulation of cash and paying off debt at maturity or by call, has reduced funded debt and equipment obligations outstanding in the hands of the public from $228 million in 1933 to $192 million at the end of 1944, or 16 per cent. These debt reductions, the lower cost of equipment financing, and a $53.8 million refunding issue at an interest cost to the company of 3.20 per cent, have reduced fixed charges 32 per cent, from $10.2 million in 1933 to a present rate of $7 million. Net working capital has increased from $21 million to $45 million.

Atlantic Coast Line since 1935 has retired $43 million mortgage, collateral and debenture debt and has increased equipment obligations outstanding by $21 million, thus showing a net reduction of debt from $150 million to $128 million, the net effect being to reduce interest charges from $6.3 million to $4.8 million, or 24 per cent.

The Atchison, Topeka and Santa Fe has retired over $90 million debt or 27 per cent and reduced interest charges by $3.2 million, or 24 per cent, in the last four years alone. The Chicago, Burlington and Quincy Railroad has utilized surplus cash receipts to retire $53 million debt since 1941 and still leave net working capital substantially higher. In three years, therefore, the company has accomplished a 21 per cent reduction in debt which, aided by the refunding issue of November 1944, resulted in a 26 per cent decrease in interest.

The outstanding example of accumulation of cash in preparation for paying off debt is the Union Pacific. The callable issues of this road were refunded in 1936 and 1940 at 3½ per cent. Since then large cash balances have been built up and new equipment has been bought on credit at low interest rates to conserve cash. Net current assets November 30, 1944 were $149 million and the company has announced its intention to continue the policy of conserving cash so as to be in a position to meet system maturities of $52 million in 1946 and $104 million in 1947. Refundings so far have saved the system an estimated $1.3 million yearly net, and if the forthcoming maturities should be paid off in cash the aggregate saving in fixed charges since 1940 would be close to $8 million yearly, which would cut the 1940 charges in half.

The New York Central System has effected much the largest debt repayment of any road, over $250 million having been retired since 1932, including $58 million converted into stock. During the depression economies were instituted, efficiency tightened up and the long, hard road of debt repayment begun. Interest charges on an annual basis have been reduced nearly $14 million, or 29 per cent. In addition, net current assets have risen from $15 million in 1940 to $118 million in November 1944.

The Southern Pacific has reduced debt exclusive of equipment obligations by more than $190 million or 25 per cent since early 1940 through redemptions and open market purchases, and has increased net working capital substantially at the same time. Annual fixed charges have been reduced by more than $7.3 million, or over 23 per cent below 1939 levels

The Missouri Kansas-Texas Railroad has established a noteworthy record of debt reduction. As a result of repayments of $6 million in 1942 and $15 million in each of 1943 and 1944, fixed interest-bearing debt, including equipment trust certificates, now stands at

$58.7 million and fixed interest charges at $2.5 million yearly. This represents a 38 per cent reduction in fixed interest bearing debt and a 41 per cent cut in fixed interest in three years — all accomplished from earnings.

The foregoing are some of the interesting examples of reduction in debt and fixed charges and improvement in working capital. The list could be extended to cover practically every solvent railroad system in the country, including, to mention only a few of the largest, — Chicago and North Western, Erie, and Wabash (all recently reorganized), Delaware & Hudson, Illinois Central, Pere Marquette, Reading, New York, Chicago & St. Louis, and Southern. In addition, great gains in working capital and in general credit position have been made by those roads, operating one-third of the mileage in 1939, which are readjusting and reorganizing their capital structures. The Baltimore & Ohio has retired $100 million of debt and arranged under the McLaughlin Act for extension of maturities and replacement of fixed by contingent interest.

Finally great progress has been made in setting on their feet the steam railways still in receivership. The thirty reorganization plans already approved by the ICC contemplated reductions in debt and fixed interest of $1,467 million and $105 million, or 57 per cent and 73 per cent, respectively. There are several other reorganizations not included in these figures. All of these roads are making good use of the breathing spell to improve their property to the extent possible in wartime, and to restore working capital so that they will be able to operate satisfactorily when they emerge from reorganization.

The Future

It will be evident from these examples that the improvement in the credit rating of the roads and the market for their bonds reflects not only wartime conditions, but also a fundamentally strengthened financial structure. Part of this is at the expense of former investors, reflecting the wiping out of debt through default and reorganization. But much more represents an impressive operating and financial achievement.

Railway men recognize that in the postwar situation new problems and some old ones will confront them — such as the competition of other forms of transportation, high wage costs and high taxes, and possible periods of falling prices and depressed business activity. Present costs have yet to be tested with a normal volume of traffic. Reduction in debt and interest charges will make it easier to meet unfavorable developments. Accumulated liquid resources will help the roads carry out the property improvement and modernization that is necessary if they are to maintain their position in the competitive transportation system of the country.

While the position of bondholders has improved, it should be added that the stockholders of the railroads, whose holdings also represent a huge investment, have received meager returns. Never has the essential character of the service rendered by the capital invested in railway property and operation been so impressively demonstrated as during the war. The lesson is that public policy, both in rate-making and in treatment of competing transport agencies, should not permit the railroads to be starved to the point of becoming unattractive to capital or of impairing a service that the country needs not only in emergencies, but at all times.

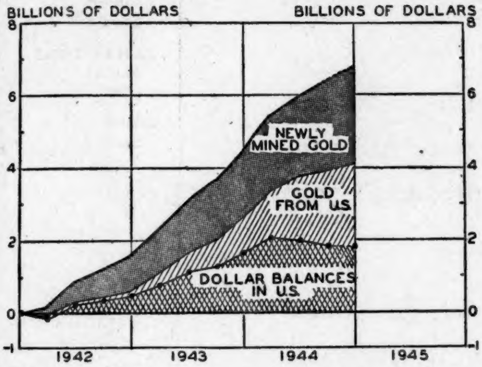
Foreign Gold and Dollar Resources

The amount of gold and dollar resources accumulated in the hands of foreigners is a subject of continuing interest in this country. Its bearing on the ability of foreign countries to buy American goods, and on the question of the size of postwar loans necessary for economic reconstruction and currency stabilization, needs no elaboration. In our Bank Letter last August we called attention to the spectacular growth of these resources since Pearl Harbor, described its causes, and published an estimate of their size as of June 1944. The November Federal Reserve Bulletin contained a calculation of foreign gold stocks and dollar balances as of September 1944, and with further information now available it is possible to give a rough estimate as of the end of 1944. It appears that the total has continued to mount, although at a somewhat slower rate than was anticipated by us last Summer.

As will be seen from the accompanying chart, the approximate increase of foreign-owned gold stocks and dollar assets in 1942 was roughly $1½ billion and in 1943 over $2¾ billion. In 1944 the addition probably exceeded $2¼ billion. Thus, gold stocks and dollar balances of foreign countries, estimated by us to have exceeded $14 billion at the time of Pearl Harbor, must have increased since by $6½ to $7 billion, to a total of more than $20 billion. This estimate is in line with the Federal Reserve Board estimate of over $17 billion as of the end of September 1944, since the Board figure did not include foreign privately-owned bank funds amounting to $2.2 billion at that time. The allowance for increase in foreign gold and dollar assets in the last quarter of 1944 would be somewhat less than $½ billion.

Thus while the problems raised by the deficiency of gold and dollars abroad have been under discussion, new accumulations have been steadily lessening the deficiency. It would

seem from the above figures that gold and dollar resources outside the United States have increased in three years by an amount larger than the total subscription the United States is asked to make to the Monetary Fund and International Bank proposed at the Bretton Woods Conference. Recent war developments indicate that the accumulation is likely to continue, although probably at a declining rate, for a period longer than was anticipated only a few months or even a few weeks ago.



Cumulative Increase of Gold and Dollar Balances of Foreign Countries, 1942-1944
(Newly Mined Gold Excluding Russia)

Rate of Growth Tapering Off

One of the reasons for the tapering off of the rate of growth of foreign gold stocks and dollar balances seems to be, as will be shown later, the declining output of new gold. We can only speculate what the other reasons have been, since most of the pertinent information on wartime international payments is withheld. Most likely our net international "cash" outlays—excluding lend-lease or mutual aid transactions—have been somewhat less than in 1943 or than was anticipated earlier in 1944, although the excess of our merchandise imports over our "cash" exports, which was $760 million in 1943, aggregated around $900 million in 1944.

A number of developments suggest a trend toward lower "cash" expenditures overseas. The withdrawal of the bulk of our forces from the British Isles and Australia, the restriction of spending by our troops on the Continent, and the completion of various projects in Latin America and elsewhere may have reduced the outflow of dollars. Likewise it is possible that some of the liberated countries are beginning to draw on their assets here in connection with postwar rehabilitation.

Foreign dollar balances in this country have declined slightly. They reached the peak of $5.5 billion in March 1944; thereafter they turned downward, and by September 1944, the latest available date, they dropped to $5.3 billion. A breakdown of the figures, however, shows that the declines have been entirely in the official funds with the Federal Reserve Banks; private dollar balances, representing largely working funds here, have increased somewhat. The decline in official balances reflects conversion of dollars into gold by certain foreign central banks and governments.

U. S. Loss of Gold in 1944

Our 1944 gold losses, allowing for newly-mined metal, were some $1,350 million, by far the largest on record. Since the increase in gold stocks earmarked for foreign account was $414 million (11 months' figure), some $900 million of gold (net) must have been shipped out of the country. In 1943 the loss of gold, including allowance for new production, was around $840 million, of which all but a fraction was retained here under earmark. Our gold stocks December 31, 1944, totalling $20,619 million, were down almost $2,200 million from $22,800 million at the time of Pearl Harbor.

In some cases foreign central bank and other reports have provided clues to the movement of the metal. Cuba bought here some $70 million of gold in 1944; Argentina repatriated $60 million during the first 9 months of 1944, while Colombia, Venezuela, Uruguay and Brazil earmarked here or repatriated in the same period over $100 million of gold. China also was among the countries which withdrew gold in 1944, and gold was shipped to various Middle-Eastern countries and to India.

World Output of Gold

As in 1943, the entire output of newly-mined gold was again retained abroad in 1944, some of it going into private holdings in the Middle East, India and Latin America. The preliminary estimate of 1944 world output by the American Bureau of Metal Statistics is about $960 million. This is about 10 per cent less than the 1943 estimate of $1,050 million and almost $500 million, or one-third, less than the peak year of 1940.

Value of World Gold Production
(In Millions of Dollars)

	1940	1941	1942	1943	1944*
South Africa	$ 492	$ 504	$ 494	$448	$432
Canada	186	187	169	128	103
Australia	58	58	43	29	20
Other British countries	106	103	85	68	63
United States	170	169	125	49	85
Mexico	31	32	28	28‡	28‡
6 Latin American countries†	64	62	56	56	54
Total reported above	$1,107	$1,110	$1,000	$806	$735
World output**	1,432	1,429	1,258	1,050	960
Reporting countries per-cent of world output	77.8	77.8	79.8	76.8	76.6

* Preliminary; † Brazil, Chile, Colombia, Nicaragua, Peru and Venezuela; ‡ 1942 figures carried forward; ** Estimates of the American Bureau of Metal Statistics.

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